

NOTE

This Microfiche meets the quality requirements of the American National Standard for Microfiche of Documents (ANSI PH5.9-1975). However, because of imperfections in the document from which it was made, it contains images that are illegible or difficult to read. The source document for this microfiche is the best copy that could be obtained prior to filming.



Congressional Information Service, Inc.
Washington, D.C.

SUBCOMMITTEE ON SOCIAL SECURITY
OF THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

**DISINVESTMENT OF THE SOCIAL SECURITY
TRUST FUNDS TO FINANCE THE PUBLIC
DEBT**



DECEMBER 16, 1985

Printed for the use of the Committee on Ways and Means by its staff

U.S. GOVERNMENT PRINTING OFFICE

55-692 O

WASHINGTON : 1985

H782-50

COMMITTEE ON WAYS AND MEANS

DAN ROSTENKOWSKI, Illinois, *Chairman*

SAM M. GIBBONS, Florida
J.J. PICKLE, Texas
CHARLES B. RANGEL, New York
FORTNEY H. (PETE) STARK, California
JAMES R. JONES, Oklahoma
ANDY JACOBS, Jr., Indiana
HAROLD FORD, Tennessee
ED JENKINS, Georgia
RICHARD A. GEPHARDT, Missouri
THOMAS J. DOWNEY, New York
CECIL (CEC) HEFTTEL, Hawaii
WYCHE FOWLER, Jr., Georgia
FRANK J. GUARINI, New Jersey
MARTY RUSSO, Illinois
DON J. PEASE, Ohio
ROBERT T. MATSUI, California
BERYL ANTHONY, Jr., Arkansas
RONNIE G. FLIPPO, Alabama
BYRON L. DORGAN, North Dakota
BARBARA B. KENNELLY, Connecticut
BRIAN J. DONNELLY, Massachusetts
WILLIAM J. COYNE, Pennsylvania

JOHN J. DUNCAN, Tennessee
BILL ARCHER, Texas
GUY VANDER JAGT, Michigan
PHILIP M. CRANE, Illinois
BILL FRENZEL, Minnesota
RICHARD T. SCHULZE, Pennsylvania
BILL GRADISON, Ohio
W. HENSON MOORE, Louisiana
CARROLL A. CAMPBELL, Jr.,
South Carolina
WILLIAM M. THOMAS, California
RAYMOND J. McGRATH, New York
HAL DAUB, Nebraska
JUDD GREGG, New Hampshire

JOSEPH K. DOWLEY, *Chief Counsel*
M. KENNETH BOWLER, *Deputy Chief of Staff*
ROBERT J. LEONARD, *Chief Tax Counsel*
A.L. SINGLETON, *Minority Chief of Staff*

SUBCOMMITTEE ON SOCIAL SECURITY

JAMES R. JONES, Oklahoma, *Chairman*

ANDY JACOBS, Jr., Indiana
RICHARD A. GEPHARDT, Missouri
WYCHE FOWLER, Jr., Georgia
BRIAN J. DONNELLY, Massachusetts
WILLIAM J. COYNE, Pennsylvania
SAM M. GIBBONS, Florida

BILL ARCHER, Texas
PHILIP M. CRANE, Illinois
HAL DAUB, Nebraska
JUDD GREGG, New Hampshire

CONTENTS

	Page
Introduction	1
I. Present Law and Practice	2
II. Treasury Disinvestment Actions	5
III. Major Issues:	9
A. The Legality and Propriety of Disinvestment	10
B. The Relationship Between the Treasury and the Congress on the Debt Ceiling	12
C. The Use of Social Security Payroll Tax Revenues to Finance General Expenses	13
D. The Fiduciary Responsibility of the Managing Trustee	15
IV. Legislative Responses:	16
A. Reporting and Notification	16
B. Prevention of Future Disinvestment Action	17
C. The Normalized-Tax Transfer Mechanism	17
D. Order for Cancelling Long-Term Reserves	18

APPENDIXES

Appendix I--"The Disinvestment of the Social Security Trust Funds, Prepared by the Congressional Research Service	23
Appendix II--Memo from the General Accounting Office on "Treasury's Management of Social Security Trust Funds During the Debt Ceiling Crises"	38
Appendix III--Letter from the Secretary of the Treasury to the Conferees on H.J. Res. 372, legislation to increase the debt limit, October 22, 1985.	67

DISINVESTMENT OF THE SOCIAL SECURITY TRUST FUNDS TO FINANCE THE PUBLIC DEBT

INTRODUCTION

In the months of September, October, and November of 1985, the Secretary of the Treasury acted to cancel \$28 billion of long-term, specially issued bonds held by the Old-Age, Survivors', and Disability Insurance (OASDI) Trust Funds in order to prevent the government from incurring debt in excess of the statutory ceiling. Under this process the Treasury essentially converted internally-held government debt owed to the social security trust funds into new borrowing authority, which allowed the government to continue temporarily to finance its obligations, pending the enactment of legislation to increase the debt ceiling. Similar procedures, though of a lesser magnitude, were followed in September and October of 1984.

The procedures the Treasury followed, often referred to in combination as disinvestment, have proved to be very controversial in the Congress. Many Members have argued that the disinvestment of OASDI reserves was improper, and that the Secretary of the Treasury acted in direct violation of the requirements and intent of the Social Security Act. Concerns have been raised about whether this practice led to the use of social security payroll tax revenues to underwrite the general expenses of government, despite the fact that social security is a self-financed program, with payroll taxes earmarked to pay only for benefits and administrative expenses under the program.

Additionally, a number of Members believe that the policy of disinvestment amounts to a means through which the executive branch effectively raises or circumvents the debt ceiling, which by law can only be increased by Congress. This circumvention casts doubt upon past and current statements made by the Secretary of the Treasury

to the Congress identifying the point at which the government runs out of borrowing authority, and must confront default without a legislated increase in the debt ceiling.

Further, it has been argued that the Secretary of the Treasury, in his capacity as Managing Trustee of the OASDI trust funds, breached his fiduciary responsibility by subjecting the OASDI trust funds to a significant risk of long-term interest loss through the cancellation of high-yielding bonds. The Secretary of the Treasury faced a conflict of interest, and chose to put the trust funds at risk in order to postpone temporarily the default of the government on its obligations.

This report examines the policy and procedures of disinvestment, and discusses the major issues and legislative options associated with it. The first section discusses present law and normal practice with respect to the financing of social security benefits with payroll tax revenues. The second section describes the disinvestment actions taken by the Treasury in 1984 and 1985. The third section discusses the fundamental policy issues surrounding the policy of disinvestment. The final section outlines a number of possible legislative responses to the issues raised by disinvestment, including a review of larger, structural changes that might prevent disinvestment from occurring in the future. Appendix I to this report is a legal opinion on disinvestment prepared by the Congressional Research Service (CRS). Appendix II contains a General Accounting Office (GAO) analysis of disinvestment, including a comprehensive factual description of what occurred in 1984 and 1985 and GAO's legal opinion on this subject. Appendix III is a letter from the Secretary of the Treasury to the House and Senate conferees on legislation to increase the debt limit that discusses the disinvestment of the social security trust funds.

I. PRESENT LAW AND PRACTICE

Section 201 of the Social Security Act specifies the procedures that are to be followed in financing current monthly benefit expenditures with social security payroll tax receipts and in maintaining, in the form of long-term invested reserves, any surpluses of income over outgo that accrue to the trust funds over time.

Section 201(a) defines the "normalized tax transfer" (NTT) process through which monthly payroll tax deposits are made available at the beginning of the month to pay for benefit checks which are sent out at that point. The NTT procedure was established by the Social Security Amendments of 1983 (P.L. 98-21), and is designed to assure that the trust funds have on hand at the start of the month sufficient funds to pay benefits from monthly revenues.

Under this procedure, on the 1st of the month the Treasury transfers to the OASDI trust funds an amount equal to expected OASDI tax revenues for that month and invests these funds in short-term "certificates of indebtedness" (CI's). On the 3rd, 7th, and 8th of the month, the Treasury redeems, in three stages, sufficient CI's to finance benefit payments. The first redemption, which equals about 50 percent of the total benefit expenditure, covers the benefits transmitted electronically. The second two stages finance checks sent through the mail.

Throughout the month the Internal Revenue Service (IRS) collects the OASDI revenues and deposits them in the general fund of the Treasury. These deposits reimburse the Treasury for the NTT funds supplied in advance to the trust funds. Any interest advantage the OASDI trust funds gain as a result of receiving total tax income at the beginning of the month, rather than on a daily-flow basis, is repaid to the Treasury on a semi-annual basis.

Section 201(d) of the Social Security Act states that the Managing Trustee (the Secretary of the Treasury) shall invest in interest-bearing obligations any funds that are not required to meet current withdrawals. Under the Treasury Department's procedures, any CI's which are not needed to pay benefits are held until they reach maturity on the next June 30th, when accumulated short-term surpluses are rolled over each year into specially-issued Treasury bonds with maturity dates ranging from 1 to 15 years. These bonds serve as the long-term reserves of the OASDI trust funds, and will build rapidly over the next two decades as a result of increasing surpluses. In 1985, OASDI income is expected to exceed outgo by about \$6.6 billion.

Both CI's and long-term bonds are invested at a rate of interest specified in the law (viz., the interest will equal the average market yield on marketable Federal obligations that are due or callable 4 or more years from the time when the special obligation was issued). The Treasury attempts to set the maturity dates for special issue bonds from 1 to 15 years so that about 1/15th of these long-term securities come due each year.

Historically, the Treasury has employed a particular order for redeeming CI's and bonds in the event that internal social security financing problems require drawing down upon reserves. Under this practice, the first securities redeemed are special issues due to mature on the following June 30th. These are redeemed at par and in ascending order of interest rates. If additional funds are needed, special issue bonds due to mature one year later are redeemed, again at par and in ascending order of interest rates.

The purpose of the NTT process and the investment policy set out in section 201 of the Social Security Act is very simple and direct: monthly social security payroll tax receipts are made available in advance to finance monthly social security benefits. Any surplus funds

developed over time are invested, and can be drawn down in the event that untoward economic circumstances result in payroll tax revenues not equalling benefit obligations.

On August 31, 1985, the date before any disinvestment action this year, the OASDI trust funds held a total of \$37.2 billion in invested securities (\$2.8 billion were held in short-term CI's and \$34.4 billion were invested in long-term bonds). Of this amount, \$5.2 billion was held in 13 3/4 percent bonds, \$8.9 billion in 10 3/4 percent bonds, \$21.0 billion in 10 3/8 percent securities, \$766 million at 9 3/4 percent, and \$387 million at 8 3/8 percent.

II. TREASURY DISINVESTMENT ACTIONS

Under disinvestment, all or part of the expected monthly payroll receipts are not made available to the trust funds to finance benefits at the beginning of the month. To make up the shortfall, long-term bonds are unilaterally cancelled to cover the cost of benefits. This procedure departs significantly from the specifications in the Social Security Act. However, the Treasury has justified such action on the grounds that if disinvestment were not executed, the government would default, and social security checks, among other Federal obligations, could not be honored.

When the Treasury disinvests, the initial step occurs on the 1st of the month, when the Treasury credits, but does not invest, NTT funds to the OASDI account. These uninvested funds cannot be used to pay benefits and do not earn interest; they are similar to cash holdings except there is no cash to back them. Thereafter, the Treasury cancels sufficient OASDI long-term bonds to finance social security benefit payments. The cancellation of OASDI securities creates space under the debt ceiling to allow the government to borrow funds on the market. In combination, these actions allow the government to circumvent the

debt ceiling by raising cash while not technically increasing the amount of debt outstanding that is subject to the limit.

Throughout a month in which disinvestment occurs, the IRS continues to deposit payroll receipts in the general fund of the Treasury, despite the fact the NTT funds were only transferred as a paper "IOU", and not invested in securities available to pay benefits. Expected receipts are not made available to finance benefit payments and real payroll tax receipts are withheld from the trust funds. Thus, the Treasury utilizes OASDI resources in two ways: 1) through the daily receipt of payroll tax revenues which are deposited in the general fund and can be used as cash for purposes unrelated to social security; and 2) through the unilateral cancellation of long-term reserves to generate new borrowing authority. In combination, the OASDI contributions to the Treasury substantially exceed the OASDI withdrawals in the form of benefit payments. For example, in October 1985 none of the \$12.8 billion in NTT funds were made available to pay benefits. Instead \$13.4 billion in invested OASDI reserves were cancelled to finance benefits. The combined OASDI contribution of \$26.2 billion nearly doubled the amount needed to pay for benefits.

An important aspect of the policy of disinvestment is that both steps, the failure to invest NTT funds and the subsequent cancellation of long-term bonds, are closely intertwined, and cannot be understood in isolation. Because the NTT funds that are transferred are not invested, the "transferred" funds are not available to pay benefits. Instead the amount of the "transfer" is only credited, on paper, in an account that represents only a future promise to invest the funds at some later point. The artificial shortfall created by the failure to invest the NTT funds subsequently requires the cancellation of long-term securities that otherwise would not have been affected by the monthly payment of benefits. Current income is shut off, and long-term reserves

that would not ordinarily be affected are drawn down to cover current outgo. The result of this practice is that social security reserves are not redeemed in the conventional sense in which cash is traded for the retirement of an obligation. Instead, the reserves are simply cancelled, and the party that holds the reserves, the OASDI account, receives no immediate reimbursement for the resources lost.

Though the cancelled reserves are ultimately reinvested once the ceiling on the public debt is lifted, the trust funds stand to lose long-term interest if the bonds cancelled are replaced with securities with lower yields. For instance, in September and October of 1984 the Treasury cancelled \$9.8 billion in long-term bonds with yields of 13 3/4 percent and 10 3/4 percent and maturity dates ranging between 1986 and 1991. When the debt ceiling was raised, these funds were reinvested in short-term CI's, and then rolled over on June 30, 1985 into long-term bonds. The yield on the June 30, 1985 special issues was 10 3/8 percent. Thus, the OASDI trust funds faced a permanent loss of the interest differential between the higher rates that prevailed at the point of cancellation and the lower yield offered upon reinvestment. Had restorative legislation not been enacted in 1985, the estimated loss to the OASDI trust funds through 1991 would have been \$440 million.¹/

Substantial disinvestment actions were taken in September, October, and November of 1985. In 1985, a total of \$27.9 billion in long-term bonds were unilaterally cancelled and a total of \$28.2 billion in payroll tax receipts were not invested

-
1. "Long-Term Effects of Debt Limit Problems in 1984 on the Interest Earnings of the Social Security Trust Funds -- INFORMATION," November 7, 1985, Memorandum of Harry C. Ballantyne, Chief Actuary, Social Security Administration, U.S. Department of Health and Human Services.

during these months. (A thorough narrative of the disinvestment events in 1984 and 1985 appears in Appendix II of the GAO report.)

The disinvestment process in 1985 began on September 3 (the first business day of the month), when the Treasury invested only \$5.66 billion of the \$13.58 billion in expected OASDI payroll taxes for the month. Later in the month, the Treasury eventually invested the outstanding NTT balances in short-term CI's. However, in the interim, a total \$6.9 billion in long-term bonds earning interest at 10 3/8 percent and with maturity dates in 1987 and 1988 were cancelled.

In October, NTT funds were credited but not invested. Benefit payments were financed from the CI's obtained from the delayed investment of the September NTT funds, and from the cancellation of \$4.76 billion in 10 3/8 and 10 3/4 percent bonds with maturity dates in the years 1989, 1990, and 1991. At the end of October, a cumulative total of \$15.1 billion in OASDI payroll tax receipts had not been invested and made available for the payment of benefits.

In November, the Treasury again did not invest any of the NTT funds. To finance benefit payments, the Treasury unilaterally cancelled \$9.6 billion in long-term bonds on November 1, \$4.2 billion on November 4, \$715 million on November 8, and \$266 million on November 12. By the middle of the month, the OASDI long-term reserves had been depleted to a level of \$9.1 billion. A total of \$13.1 billion in November NTT funds had not been invested. Cumulatively, by November 13th, \$28.2 billion of the OASDI portfolio was held in an uninvested account, none of which could be used to pay benefits on December 3.

In November, the Treasury departed slightly from the disinvestment procedures followed in September and October, by accelerating the cancellation of bonds in advance of the date necessary for benefit payments. This acceleration appears unprecedented, and cost the trust funds

\$9 million in short-term interest loss. Secondly, the order of cancellation was revised, with bonds drawn down by rate of interest, rather than maturity date. This departure from historical redemption policy assured that none of the more valuable 13 3/4 percent bonds held by the OASDI trust funds were lost through disinvestment.

On November 14, a temporary \$80 billion extension of the debt ceiling was enacted into law. As a result of this legislation, the Treasury was able to follow conventional NTT procedures for the payment of December benefits. The extension also requires that the Treasury replace the long-term bonds cancelled in October and November of 1985 with bonds identical with respect to yield and maturity date to those so cancelled. This action will assure that any potential long-term interest loss associated with disinvestment in October and November of 1985 will not occur.

Similar restorative legislation for the disinvestment of bonds in September of 1985, and September and October of 1984, was enacted on December 12, 1985 as part of H.J. Res. 372 (legislation to permanently raise the debt ceiling). In both cases, the purpose of restorative legislation is to make the trust funds "whole", and assure that no loss of interest occurs as a result of disinvestment.

III. MAJOR ISSUES

The policy of disinvestment poses a number of serious and disturbing questions about the legality and propriety of the Secretary of the Treasury's decision to violate the requirements of the Social Security Act in order to enable the government to borrow funds that the debt ceiling would otherwise prohibit the government from obtaining. These actions raise the issue of the impact of the policy of disinvestment on the historical relationship between the Congress and the Treasury with respect to the management of the government debt and the legal meaning of the debt

ceiling. Further, disinvestment can be viewed as a mechanism through which social security payroll taxes are used to finance general government expenses, contrary to the intent of Congress and the general understanding of the public. Also, these actions raise the question of whether the policy of disinvestment amounts to something akin to a breach of fiduciary responsibility by the Secretary of the Treasury in his capacity as the Managing Trustee of the OASDI trust funds.

A. The Legality and Propriety of Disinvestment

Under the Social Security Act, the role contemplated by Congress for the Secretary of the Treasury in managing and investing the OASDI trust funds is essentially a ministerial one. The OASDI trust fund reserves are to be invested under a very rigid formula specified in the law. Compared to many other Federal trust funds, there is little discretion in the area of investment policy. The Social Security Act specifies in Section 201(a) that the Secretary of the Treasury shall invest, at the beginning of each month, expected monthly payroll tax receipts in United States obligations in the same manner and to the same extent as he invests the OASDI trust fund surpluses. This mechanism, established by the Social Security Amendments of 1983, is mandatory, and does not imply any discretion on the part of the Managing Trustee. Choosing to postpone the investment of the NTT funds, and instead withholding them in an uninvested account, therefore violates the requirements and express intent of the Social Security Act. (The CRS legal opinion, contained in Appendix I, provides a thorough discussion of this issue.)

The Treasury states that it was forced to abandon the conventional procedures for the investment of expected payroll tax receipts on the grounds that the issuance of new debt was impossible given debt ceiling constraints. These constraints placed the Treasury in a position in which long-term OASDI bonds had to be cancelled to

generate sufficient borrowing authority to assure the government could obtain cash to honor its general obligations (including social security benefit payments). Placed between "a rock and a hard place," the Treasury believed that it would be better to circumvent the debt ceiling by not following the letter of the Social Security Act than to reach the limit, and jeopardize government operations.

The Congress has intentionally structured the social security trust funds to stand as independent entities, self-funded, and separate from the general operations of the government. Relationships between social security and other government accounts and programs are supposed to be carefully accounted for, and generally parallel the relationship between two distinct entities with defined, contractual responsibilities. Disinvestment represents a blurring of these distinctions. Certainly, the utilization of OASDI resources to serve the requirements of the general fund is not contemplated under the Social Security Act.

An important aspect of this issue is that historically, the Congress has relied upon the precise estimates provided by the Treasury on the date the government will default if action is not taken to raise the debt ceiling. These estimates set the deadlines for Congressional action, and keep the Congress apprised on developments in the management of the debt. Over time, the Congress has always in the end increased the limit on borrowing authority, and the government has never had to default on its obligations.

In the beginning of September, without notifying Congress in advance, the Treasury chose to abrogate a legal obligation to the OASDI trust funds by not making the full amount of expected receipts from the payroll tax in September available at the beginning of the month to pay benefits. It then converted long-term OASDI bonds into new borrowing authority through unilateral cancellation. Apparently, the Treasury did not

view this circumvention of the debt ceiling as extraordinary, but as rather a normal course of action given the situation.

B. The Relationship between the Treasury and the Congress on the Debt Ceiling

At other points throughout the debt ceiling impasse, however, the Treasury did inform Congress that if the debt ceiling were not increased, it would be forced to not honor general government obligations. For instance, the Treasury warned the Congress that if the ceiling on the public debt were not lifted by the middle of November, the Treasury could not honor a large amount of interest payments owed to private investors. This warning was conveyed with sufficient seriousness and urgency that the Congress did temporarily extend the debt ceiling, and avoided the possibility that these commitments could not be met.

The Treasury's decision that failure to meet internal obligations to the OASDI trust funds is less serious than failure to meet external obligations to private parties has no fundamental basis in law, but is rather an administrative viewpoint grounded on the differing consequences of the two actions.

In this sense, the Treasury has divided the government's debt into two orders. First, a higher order which involves obligations that cannot be breached, and second, a lower order, which to a certain degree can be violated if the Treasury confronts a debt ceiling crisis.

Under the law, however, no such distinction is made; both forms of debt are subject to the limit. By converting internally-held debt into "non-debt" that does not earn interest and does not count against the debt ceiling, the Treasury appears to be circumventing the intent of Congress that total debt subject to the limit not exceed a certain level. Through the use of disinvestment, an absolute limit set in law apparently becomes a

moving target. In the future, therefore, the Congress may want to approach debt limit statements made by the Treasury with a degree of skepticism.

In a report to the Committee on Ways and Means in 1979, the General Accounting Office commented that the redemption of securities held by the economic stabilization fund in 1978 may not have been appropriate in that this action "represented a circumvention of the intent of the debt ceiling".^{1/} GAO also noted that it supported the decision of the Secretary of the Treasury that it would be improper to disinvest the social security trust funds to circumvent the debt ceiling. This report thus supports the view that the premature redemption of internally-held government securities to evade the debt ceiling represents a distortion of the process envisioned under the law.

C. The Use of Social Security Payroll Tax Revenues to Finance General Expenses

The social security program is self-financed, with benefit payments and administrative expenses funded by a dedicated payroll tax and revenues from a limited tax on benefits. When the social security system encounters financial problems (as the program did in the early part of this decade) benefits cannot be financed directly through the general fund; either legislation must be enacted to restore solvency to the system, or benefits cannot be timely provided. When social security builds surplus reserves (as is the case presently), the excess of income over outgo cannot be directly channelled into the general fund to finance unrelated programs or expenses. Rather,

-
1. Report by the Comptroller General of the United States, September 9, 1979, "A New Approach to the Public Debt Legislation Should Be Considered", Report # FGMSD 79-58, pp. 11-12.

these surpluses are held in the form of debt from the Treasury, and are counted as assets of the OASDI trust funds.

The policy of disinvestment dissolves the financial boundaries that by law divide the OASDI trust funds and the general fund. In any month that disinvestment occurs, the OASDI trust funds contribute far more in resources to the general fund than they receive in return. In this way, disinvestment can be viewed as a chain of events through which the general expenses of government are temporarily underwritten by social security trust funds.

For instance, in November 1985, the Treasury invested none of the NTT amount credited to the OASDI accounts, and therefore, none of it was available to finance benefits. Instead, an amount equal to November's expected payroll tax receipts was drawn down through the cancellation of long-term bonds to finance November benefits. Throughout the month, payroll taxes were deposited in the general fund, despite the fact that the NTT funds were not invested. Thus, in November the Treasury covered its expenditure for social security benefits by cancelling long-term bonds; any payroll tax income received by the general fund thereafter amounted to the OASDI account's subsidizing the general expenses of government. Since the NTT funds had not been invested, there was nothing the OASDI account owed to the general fund as reimbursement for benefit payments.

Through its actions the Treasury appears to view the legal distinction between the OASDI accounts and other expenses of government as not particularly meaningful in time of a debt ceiling crisis. Under this view, if new debt cannot be issued under the law, then it is appropriate to cancel internally-held debt to create room for new debt. If social security payroll tax revenues are collected that have not been effectively posted to the OASDI accounts, it is nonetheless appropriate to utilize those revenues as cash. From this perspective, the government is a single account

and this singularity overrides any claims held by separate, sub-accounts such as social security.

This approach runs counter to the long-held understanding of the Social Security Act's creation of the trust funds, and can be viewed as a misuse of OASDI funds to serve the ends of the general fund. The separation of the OASDI accounts from the general operations of the government is set in law; dissolving this boundary controverts the law. It has been suggested that in some respects this action parallels the comingling of funds which is prohibited in private industry.

D. The Fiduciary Responsibility of the Managing Trustee

Under the law, the Managing Trustee is not held liable specifically as a fiduciary for actions taken with respect to the trust funds. However, he is entrusted with certain duties under the law, including the mandatory investment of OASDI income and reserves in debt obligations with due regard to the needs of the OASDI trust funds. To the extent the Managing Trustee fails to fulfill his duties, such as the investment of NTT funds, he is acting to sacrifice the interest of the trust funds to meet some other objective. This sacrifice can be viewed as similar to a breach of fiduciary responsibility on the part of the Managing Trustee.

In September, October, and November of 1985, the Secretary of the Treasury encountered a conflict of interest between his role as Treasurer of the general fund and his role as Managing Trustee of the OASDI trust funds. Through the policy of disinvestment, he chose to protect the former, to the possible detriment of the latter, on the grounds that the consequences of general default were much greater than the loss of long-term interest to the trust funds. The Secretary made this choice without informing the Congress in advance of his intentions to do so, and without consulting with or even notifying the

other Members of the Board of Trustees (the Secretary of Health and Human Services, the Secretary of Labor, and two public trustees).

These actions call into question whether the current arrangement is appropriate, and whether the OASDI trust funds are managed by an agent who will always consider first the fund's long-term needs. For instance, it may be in the interest of the Secretary of the Treasury to cancel higher yielding long-term bonds on the expectation that their reinvestment at lower yields will minimize the interest expenses of the general fund in the future. It has been suggested that the line drawn between social security and the general expenses of government should be highlighted to assure that the Social Security Act is strictly followed by the executive branch.

V. LEGISLATIVE RESPONSES

The policy of disinvestment has proven to be a subject of enormous controversy in the Congress. Legislation to assure that the trust funds suffer no disadvantage as a result of disinvestment of securities in 1984 and 1985 has already been enacted. In addition to restorative legislation, a number of proposals to prevent or prohibit disinvestment in the future have been introduced, and may receive legislative consideration in the next year.

A. Reporting and Notification

In 1984 and 1985, the Managing Trustee did not inform the other Members of the Board of Trustees or the Congress of his decision to disinvest the OASDI trust funds. Some Members of Congress have advocated legislation that would require the Secretary of the Treasury (as Managing Trustee) to notify each Member of the Board of Trustees, and the Chairmen of the Committee on Ways and Means and the Committee on Finance, in advance of any planned action to either disinvest securities or fail to conduct the full NTT process. The

approach would make public any disinvestment decision in advance of its execution. This approach does not alter or prohibit the policy of disinvestment itself.

Currently, the Board of Trustees does little more than report to Congress once a year on the financial status of the trust funds. For all intents and purposes, the funds are managed exclusively by the Managing Trustee, and none of the other trustees make a significant contribution to the financial operation of social security. The role of the Trustees could be enhanced by providing the Members with additional authority to oversee the decisions of the Managing Trustee, and to meet on a more regular basis (e.g., monthly, bimonthly). The advantage of this approach is that the Board Members would have the information and the authority to contribute to administrative decision-making, and make the process more open to public and Congressional inspection. On the other hand, this participation should be unnecessary, as the Managing Trustee performs a ministerial role, and few of his decisions involve any discretion.

B. Prevention of Future Disinvestment Action

Rather than relying on the affirmative requirements contained in the Social Security Act with respect to the use of payroll taxes to finance benefits, the law could be amended to specifically prohibit future disinvestment as a result of debt ceiling-related cash shortages. Such a prohibition would severely restrict the Secretary's ability to transform internal debt into external borrowing authority.

C. The Normalized-Tax Transfer Mechanism

Without the normalized-tax transfer mechanism, disinvestment would be somewhat more difficult to accomplish. Rather than a once-a-month "window" to fail simultaneously to invest the advance receipts and draw down on long-term reserves, the

Treasury would have to fail to invest the payroll tax deposits on a daily basis throughout the month, building up to the cancellation of long-term reserves at the beginning of the following month.

The NTT mechanism was adopted as one of a number of technical provisions to prevent insolvency in 1983, and in many respects, it may no longer be required from a financing standpoint, at least after the 1988 payroll tax increase takes effect. Eliminating the advance-tax transfer, and reverting to the previous accounting system -- October's daily receipts financing benefits paid in the beginning of November -- would not substantially alter the financial condition of social security, unless there were to be a severe economic downturn between now and 1989. On the other hand, the advance-tax transfer is a neutral method of accounting, and neither the Treasury nor the trust funds gain or lose as a result of its operation.

D. Order for Cancelling Long-Term Reserves

Over the past 50 years, the Secretary has pursued a redemption policy of drawing down social security reserve bonds by order of maturity, not interest rate. This policy worked to the disadvantage of the trust funds in the late 1970's and early 1980's when interest rates were high, and reserves were often redeemed to prevent the system from becoming insolvent. This policy also resulted in the cancellation of high yielding 13 3/4 percent bonds in October of 1984. In November of 1985, the Treasury broke with tradition, and followed a cancellation order based on rate of interest to protect the 13 3/4 percent bonds.

To the extent that a conflict of interest exists between the Secretary of the Treasury as Managing Trustee and as Treasurer of the general fund, it might be useful to specify in law that the redemption order be based on interest rate,

rather than maturity. This change would eliminate the conflict of interest, and would instill prudent investment practices into the permanent management of the trust funds.

E. Structural Changes

A fundamental change to prevent the general conflict of interest that faces the Secretary of the Treasury would be to transfer the role of Managing Trustee to some other official or Board. This would not be unprecedented -- the Railroad Retirement Board (RRB) manages the railroad trust funds, and any investment request made by the RRB must be carried out by the Secretary of the Treasury.

The role of the Managing Trustee could be transferred to the Secretary of Health and Human Services, or the Commissioner of Social Security. Alternatively, the Social Security Board contemplated by H.R. 3470 (legislation to establish the Social Security Administration as an independent agency that is awaiting consideration before the full Committee on Ways and Means) might serve as an appropriate locus of authority for the management of OASDI finances.

APPENDICES

Appendix I.--"The Disinvestment of the Social Security Trust Funds," Prepared by the Congressional Research Service

Appendix II.--Memo from the General Accounting Office on "Treasury's Management of Social Security Trust Funds During the Debt Ceiling Crises"

Appendix III.--Letter from the Secretary of the Treasury to the Conferees on H.J. Res. 372, legislation to increase the debt limit, October 22, 1985

Appendix I



Congressional Research Service
The Library of Congress

Washington, D.C. 20540

DISINVESTMENT OF SOCIAL SECURITY TRUST FUNDS

Raymond J. Celada
Senior Specialist In
American Public Law
American Law Division
November 17, 1985

DISINVESTMENT OF SOCIAL SECURITY TRUST FUNDS

I

Caught between an inflexible debt ceiling and going into national default on maturing governmental obligations, the Secretary of the Treasury recently engaged in a bit of creative financing to avoid these unenviable choices. In the process, the Secretary departed from long-standing policies and practices for investing and redeeming Social Security Trust Funds. Since the procedures for investing contributions from covered employment to the Old Age and Survivors Insurance Accounts are largely specified in law, the Secretary's recent actions as Managing Trustee of the funds in question have been challenged as exceeding his authority. In simple terms, are the Secretary's disinvestment activities occasioned by the inability of the House and Senate to agree on an increased debt ceiling bill, permitted by law? And if not, has the Secretary breached a fiduciary obligation owed current or future OASI/DI beneficiaries, particularly should these efforts to steer between the Scylla of the debt ceiling and the Charybdis of national default result in a loss of interest to the Social Security Trust Fund?

II

Under existing law the Secretary as Managing Trustee has little discretion with regards to the investment of receipts derived through the OASI/DI Programs. The law directs him to credit to the Trust Funds at the beginning of each month the amount of payroll tax revenues estimated to be received that month. These amounts are invested in interest bearing U.S. securities or securities that are guaranteed both as to principal and interest by the United States. Accordingly, the posting of receipts in a non-interest bearing form is not authorized by the statute but at odds with its express terms and longstanding practice.

Social Security contributions are collected from employees, employers, and the self-employed, who are working in jobs and businesses covered by Social Security, and then deposited into the Treasury. These funds and income from other authorized sources are credited to the Social Security Trust Funds through the issuance of special interest-bearing Federal securities. The trust funds are thus a depository of securities, not cash. When benefits are paid by the Treasury, short term investments termed certificates of indebtedness, which are available only for investment by the Trust Fund and, which mature on the following June 30, are redeemed, with those issues bearing the lowest interest rate redeemed first. If further investments must be redeemed, special issue bonds maturing on the subsequent June 30 are redeemed, again in ascending order of interest rates.

As best as can be determined, these redemption procedures are not expressly prescribed by law or formal regulation. They seem to be of longstanding nature, and consequently when the Secretary recently redeemed longer term securities, he departed from prior consistent practice. Whether in so doing he violated a practice which had the indicia of law or breached a trust since new and future investments may be at reduced interest rates is a debatable, but at present indeterminable, matter.

It seems to be the clear import of the law that Trust Fund assets are to be invested and redeemed with exclusive regard to the needs of the Trust Funds which, in turn, are available only for the payment of benefits or administrative expenses. Since this purpose seems both manifest and exclusive, use of Trust Fund assets for other than OASI/DI benefit payments, such as meeting general government obligations, appears to be ruled out by necessary implication.

Whether the Secretary breached his "duty" under the law particularly if his recent actions lead to a loss of substantial amounts of interest realized by the Trust Funds, is a matter that ultimately the Congress may have to decide. While there is no dearth of public officers jurisprudence, precedents analogous to the present one are difficult to find. Clearly, one can argue that the Secretary is to be held to the standard of a fiduciary selected to administer a trust and, accordingly, he should be held accountable for unauthorized actions that adversely affect trust income. At the same time, the Secretary takes an oath to support all laws passed by Congress including debt ceiling limits that constrain his authority to borrow money. Given these constraints and the adverse economic and other consequences to the nation of defaulting on obligations -- assuming that these polar positions were the only alternatives available to him -- the question of what duty takes precedence becomes a murky one not easily disposed of by the precedents.

III

Although the Social Security law and regulations and the policies and practices associated with them are the concerns of technicians, the problem which led the Secretary to take his recent, largely unprecedented actions as well as the actions themselves require no particular expertise. As well as being the Managing Trustee of the Trust Funds, he is the chief financial officer of the U.S. Government. In that latter capacity he is responsible for government financing and managing of the public debt.

The public debt limit or the maximum of government obligations is fixed by law 31 U.S.C.A. § 3101. Stated differently, the debt limit caps the Secretary's borrowing authority. As a consequence, when that limit is reached the Treasury Department may find itself between a rock and a

hard place if maturing obligations of the government exceed receipts to the government from all sources. Ordinarily, Congress comes to the rescue by statutorily raising the debt ceiling to a new level that allows the government to incur additional obligations for a more or less predetermined period of time. In the event of a congressional failure to revise upward the debt ceiling in these circumstances, the Treasury Department presumably is left to the choice of paying off maturing obligations on the basis of some schedule of priorities as permitted by the receipt of revenues and shutting down all but the most essential operations of the government. According to department sources, the nation began bumping up against the ceiling in early September.

As obligations of the United States, the assets of the Social Security Trust Funds are part of the national debt. As previously indicated, benefits authorized for OASI/DI in normal circumstances are paid through the redemption of securities posted to the trust funds. Whatever remains in the trust funds remains a part of the public debt.

Benefit checks issued under these programs are usually sent out on the third of the month; receipts which consist of contributions or taxes from various sources flow into the Treasury throughout the month. In other words, payouts and receipts are not coincident acts. A few years ago, the Congress approved an accounting procedure that eliminates the gap between the two events, among other things, in order to prevent shortfalls that might delay making benefit payments. P.L. 98-21, 97 Stat. 65 (1983). The procedure which is described by the term "normalized tax transfers" consist of "credit[ing] to the Trust Fund at the beginning of each month, the amount of payroll tax revenues that is estimated to be received during the month. These amounts [are] invested

in the trust funds as all other trust fund assets are invested and an appropriate allocation made of interest accrued on such investments." The trust funds pay interest to the General Fund for this "advance." In paying such interest, "the interest rate charged to the trust funds in any month shall be equal to the rate earned by the investments of the Trust Funds in the same month Interest shall be calculated on a daily basis and apply to an amount equal to the amount transferred on the first of the month minus the amount which would have been transferred up to that day of the month under [then current procedures]." S. Rept. No. 98-73 at 36.

Since these procedures result in an increase in public debt that is subject to a ceiling, they cannot be carried out nor, consequently, monthly payments made when that ceiling is reached. As a consequence, beginning in September when the latter occurred, Treasury did not fully invest the "normalized transfers" according to established procedure, and when benefits were paid, it redeemed older securities and bonds. Moreover, in November, in order to give it some breathing space in order to permit Congress to come to the rescue, Treasury took the "extraordinary" step of disinvesting these older and longer term securities earlier than would otherwise be customary for the payment of benefits. Both actions according to Department sources will result in a loss of interest to the Trust Funds.

IV

The assets of the Trust Fund are invested solely in U.S. government obligations, except for an occasional very small cash working balance remaining with the Treasury.* These and other matters relating to investment policies are not left to the Secretary's discretion as Managing

* Trust Fund investment practices have been cogently summarized as follows:

The assets of the trust funds are invested by the Secretary of the Treasury solely in U.S. government obligations, except for a relatively small cash working balance. The securities can be any of three types --- obligations bought on the open market, obligations bought at issue (as part of a new issue offered to the public), and special issues. In the actual operations in the past, most investments have been in special issues. The law provides that the special issues shall bear an interest rate equal to the average market yield rate on all U.S. government obligations with at least four years to go until earliest maturity (as of the issuance date of the special issue), rounded to the nearest 1/8 percent. There is no specific provision as to the period until maturity for the special issues, but in practice, it is attempted to have them in a maturity schedule spread equally over a period of 15 years.^{113/} Investment is also permitted in debt obligations that are guaranteed as to both principal and interest by the U.S. government, such as those of the Government National Mortgage Association (commonly referred to as "Ginny Mae")^{114/}

^{113/} In actual operation, monies made available for investment during a fiscal year (October 1 to the next September 30) are placed into certificates maturing at the end of the year. At that time, the proceeds from the certificates are invested in bonds (at the special-issues interest rate then prevailing), with maturities spread out as much as possible to achieve the result of equal amounts maturing in each of the next 15 years for the total portfolio (including previous years' investments). If at any time during the fiscal year money is needed because current income is less than current outgo the short-term certificates on hand are redeemed first, using those with the lowest interest rates. If no certificates are available, then the bonds with the shortest time until maturity are redeemed.

(continued)

Trustee but are largely dictated by section 201(d) of the Social Security Act, 42 U.S.C.A. § 401(d). Initially, and significantly for present purposes, the law imposes a mandatory "duty" on the Managing Trustee to invest those Social Security funds in interest-bearing obligations guaranteed as to both principal and interest by the United States. Obligations are to be purchased at the issue price for special issues or at the market price for marketable obligations. The Managing Trustee is required to invest in special issues --- short term obligations not available to the general public --- except when he determines that the purchase of obligations available in the open market is "in the public interest." Special issues shall have "maturities fixed with due regard for the needs of the trustfund" and will pay a rate equal to the average market yield on all marketable interest-bearing obligations of the United States which are not due or callable (redeemable) for at least 4 years.

(*continued)

114/Over the years, facilities for the SSA have been constructed in various cities, with the largest such costs being for the headquarters buildings in Baltimore. Although under generally accepted accounting principles these would be reported as assets of the trust funds, with later appropriate amortization, instead they have been shown as current expenses. To this extent, the assets are understated and current administrative expenses are overstated. This will be offset in the future, however, by lower reported administrative expenses. In fiscal years 1977 and 1978, such expenditures were about \$15 million and \$20 million, respectively, from all four trust funds combined. Myers, Social Security 104-105 (1981)

The language of section 201(d) leaves little leeway for arguing that the Managing Trustee may invest or may not invest funds as he for any reason sees fit. Under the 1983 revised procedures he credits the fund with the total estimated amount at the beginning of each month and "invests" the excess. He has discretion to invest in obligations available in the open market rather than special issues but only when it is "in the public interest." Neither section 201 or, as best we can determine any other section of the Social Security Act, affords him discretion to invest or not for any reason.

The absence of any seeming discretion to elect between investment or not is emphasized by other noted features of the law, conspicuously, the inflexible mandate to invest in interest-bearing obligations; the incorporation into the law of a formula used to determine the interest rate earned by special issues; and that maturities of special issues be fixed with due regard for the needs of the Trust Funds.

Anything less than secure interest-bearing investments of the kind Congress obviously had in mind when it wrote the Social Security Act and ever since might be out of step with the needs of the Trust Funds and impair the purpose of OASI/DI, namely to protect workers and their dependents from risk of loss of income due to insured's old age, death or disability. See, e.g., Delno v. Celebrezze, 347 F.2d 159 (C.A. Cal. 1965).

In recent testimony before a congressional committee, a Treasury Department official indicated that on "several occasions since enactment of the 1983 Amendments [which among other things, authorized "normalized tax transfers"] the Department has delayed investment of the normalized tax transfers in order to avoid exceeding the debt limit." John J. Niehenke, Acting Assistant Secretary Of The Treasury (Domestic Finance) Before The

Subcommittee On Social Security Of The House Ways And Means Committee, October 30, 1985. There is no indication that Congress was appraised of these alleged precedents. However that may be, practice while tending to make perfect, does not convert an otherwise unauthorized action into an authorized one. Moreover, the practice here seems to have developed very recently, too recently to permit the beneficial operation of the presumption of administrative regularity attributed to congressional inaction in the face of a longstanding administration interpretation. See Bob Jones University v. United States, 461 U.S. 574 (1983), and cited cases.

The Social Security Act does not appear to deal with the redemption of investments in the same detail as the making of investments. Section 201(e) of the Act, 42 U.S.C.A. § 401(e), provides that marketable securities purchased by the Trust Funds may be sold at the market price and special issue obligations may be redeemed at par plus accrued interest. The subject likewise seems not to be dealt with in formal departmental regulations.

The practice, however, appears to be both well known and of rather longstanding duration according to the annual reports of the Board of Trustees that is required by section 201(c)(2) of the Act, 42 U.S.C.A. § 201(c)(2) and congressional documents. One of the latter summarizes the practice as follows:

When a trust fund needs cash for current purposes. Treasury redeems securities equal in value to the amount needed. The first securities redeemed are special issues (both certificates of indebtedness or bonds) due to mature on the following June 30. These are redeemed at par and in ascending order of interest rates. If additional funds are needed, special issue bonds due to mature one

year later are redeemed, again at par and in ascending order of interest rates. Finally, after all special issues have been redeemed, Treasury would have to sell off its marketable obligations, taking a loss if necessary, since marketable securities cannot be redeemed at par. In practice, Treasury has never had to sell marketable securities in order to meet trust fund expenses; marketable securities reach their maturity dates (not necessarily on June 30), the proceeds are rolled over into new marketable bonds or into special issue bonds, depending on the anticipated cash needs of the particular fund.

Social Security Trust Fund Investments: Policies and Practices, WMCP: 97-19 (1981) at 9.

As previously indicated, the Treasury staved off the fall of the debt ceiling axe by taking the self-acknowledged extraordinary step of not fully investing the "normalized transfers" at the beginning of the month. It apparently also departed from the customary policy of redeeming the earliest maturities first. According to informed persons, one or both of these actions will result in a loss of interest to the funds as compared to normal redemption policy, although the latter was intended to minimize the interest loss.

Whether the mentioned deviations from normal practice exceed the Treasury Secretary's discretion as Managing Trustee raises a delicate question because of the apparent absence of clearcut law or formal regulations on the matter. As already noted, the procedures relating to redemption seem to be the result of longstanding practice likely developed to meet the needs of the Trust Funds. Whether this practice has taken on the aura of law because of congressional acquiescence is

problematical. See, e.g., United States v. Midwest Oil Co., 236 U.S. 459 (1915) (longstanding practice of executive withdrawals of public land); Perry v. Sindermann, 408 U.S. 593 (1972) (absence of contractual tenure provision more than made up for by college administrative practices). There seems to be little doubt that Congress was very familiar with normal redemption practices and had implicitly approved them by its acquiescence over many years. It seems unlikely that a similar statement can be made with respect to deviations from normal practice particularly where they adversely affect trust fund income at odds with the latter's needs.

VI

Little time need be spent, or so it seems, regarding whether Trust Fund assets may be used to meet general obligations of the government as such or to avoid the harsh consequences of public debt ceilings on the governments's ability to meet obligations that come due. Trust fund assets are authorized to be used for the payment of benefits or administrative expenses and any amounts not required for these purposes have to be invested "only in interest-bearing obligations of the United States or in obligations guaranteed as to both principal and interest by the United States." § 201(d); 42 U.S.C.A. §§ 401(d), 402. There appears to be no warrant in the language of that Act that would allow use of contributions or reserves for purposes other than protecting workers and their dependents from risk of loss of income due to insured's old age, death or disability. Delno v. Celebrezze, *supra*.

VII

The conclusion seems inescapable that in enacting the Social Security Act Congress to a greater or lesser extent had certain features of private trust law in mind. The repositories of the assets were called the Federal Old Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund. The Board set up to hold the funds was named the Board of Trustees and the Secretary of the Treasury was made the Managing Trustee. As such, the latter was charged with the "duty" of investing receipts and other income to the Trust Funds. Such amounts were to be invested in interest-bearing government obligations with due regards for the needs of the Trust Funds, that is to say, in accordance with the immediate and long term interests of the beneficiaries.

All of the mentioned and other features of the Act parallel private trust law principles. In particular, the latter imposes "a general power and duty [on] a trustee, implied if not expressed, ... to keep trust funds properly invested." 76 Am Jur. 2d, Trusts, § 379 (1975). Clearly, if the English language has any meaning, the Social Security Act imposed a duty on the Managing Trustee to keep Trust Funds properly invested. The Act's requirements in this regard are supported by an unbroken line of administrative practice up until recently. While in the area of private trusts one cannot say that a trustee is always liable for losses arising from investments made with trust funds, he or she may be liable depending upon such factors as "the legality and propriety of the investment and the exercise of proper care and skill on their part in making the investment, as of the time that such investments are made, and in light of circumstances then existing." *Id.* at § 381.

In conducting his disinvestment activities, the Secretary as Managing Trustee seems to have exceeded his authority under the law with respect to investing Trust Fund assets and longstanding practice with respect to redemption of those assets. As such, it may be argued that he breached a duty to OASI/DI beneficiaries, particularly as there is an all but certain loss of interest to the Trust Funds.

Moreover, public officers jurisprudence indicates that such persons who have the responsibility to hold, deposit, and invest public funds are held to an even higher standard of care than private fiduciaries.

It has generally been held that a public officer, in the absence of statutory provisions to the contrary, is held to a much stricter liability than fiduciaries handling private funds; he is absolutely liable as an insurer for the safekeeping of funds in his custody until disbursed in regular course, and is therefore liable for losses which occur even without his fault, except possibly for losses by act of God or by public enemies. This standard of responsibility is, in some cases, based on public policy, in others, on the theory that a public officer having public moneys in charge is a debtor bound to account and pay over the exact sums received, in others, on the provisions of the officer's bond, and in others, on statutory provisions fixing the responsibility of the officer.

Although the point that the funds were not private has generally not been raised in most of the cases which involve the loss by a public official of private funds received by him in an official capacity, it has been held that there is no distinction, as regards liability, between public and private funds in the official custody of an officer. However, a distinction is sometimes drawn between losses of public funds and losses of private funds; in the case of private funds, the liability of the officer is that of a bailee for hire, while in the case of public funds, his liability is absolute. 63A Am Jur. 2d, Public Officers And Employees § 393.

Whether Congress had this last mentioned as well as other features of trust law in mind is shrouded by the passage of time.

At the same time, however, it should be noted that the Secretary's actions were not intended for personal gain. Indeed, he can argue that

the disinvestment practices recently engaged in were in response to another duty imposed on him, namely, to honor the debt ceiling limit and his responsibility to the public in financing the government and managing the public debt. Either violating the former or declaring the nation in default would have had adverse implications not only on him as a public official but on the nation as a whole.

Assuming that these were the only avenues open to Secretary of the Treasury --- a judgment beyond our ken --- then Congress as the "grand inquest of the nation" is the appropriate forum for resolving whether the recent disinvestment of Social Security Trust Funds was a breach of a fiduciary obligation.

Raymond J. Celada
Raymond J. Celada *MS*
Senior Specialist In
American Public Law
American Law Division
November 17, 1985

Appendix II



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

December 5, 1985

B-221077

The Honorable James R. Jones, Chairman
Subcommittee on Social Security
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

Subject: Treasury's Management of Social Security
Trust Funds During the Debt Ceiling Crises
(GAO/HRD-86-45)

In your November 1, 1985, letter, you asked for our opinion on the legality and propriety of the Secretary of the Treasury's management of the Social Security Trust Funds (Federal Old Age and Survivors' Insurance Trust Fund and Federal Disability Insurance Trust Fund) during the government's October 1984 and September-November 1985 public debt ceiling crises. You also asked for factual information on the Department of the Treasury's actions regarding the Trust Funds and the effects of those actions on the Funds' long-term investments.

Appendix I addresses the legal issues raised in your letter. We conclude that, although some of the Secretary's actions appear in retrospect to have been in violation of the requirements of the Social Security Act, we cannot say that the Secretary acted unreasonably given the extraordinary situation in which he was operating. On the other issues you raised, we conclude that:

- Treasury may restore any interest lost because of failure to fully invest the normalized tax transfers.
- To the extent that the Trust Funds' assets were kept uninvested to permit the payment of other obligations of the government or to restore cash balances, the Trust Funds were being used to sustain the government's operations contrary to the statutory scheme.
- Because the Trust Funds transactions did not increase the total amount of outstanding debt subject to the statutory limit, the Secretary did not violate the statutory debt limit and did not usurp the congressional power under the Constitution to borrow.

(105507)

--There is no evidence that the Secretary redeemed securities, or failed to invest funds, for the purpose of avoiding General Fund interest payments to the Trust Funds, which would be contrary to his statutory duty as Managing Trustee.

Appendix II presents the factual information on Treasury's actions in not timely investing and in disinvesting Social Security Trust Funds' assets during the 1984 and 1985 debt ceiling crises.

In reviewing Treasury's recent actions, we found that normalized tax transfer (NTT) amounts were not fully invested in interest-bearing Treasury securities at the beginning of September, October, and November 1985. Instead, Treasury redeemed the Trust Funds' short- and long-term securities to meet social security benefit payments. Our analysis shows that, if adequate borrowing authority under the statutory limit had been available during September through November 13, it would not have been necessary to redeem any of the Trust Funds' long-term securities. We also found that the noninvestment of NTT amounts in September and October was not unprecedented--similar actions were taken in 1983 and 1984. However, the actions of November 1985 appear to have no precedent.

As agreed with your office, neither the Treasury Department nor other administration officials have been given an opportunity to formally review and comment on this report. However, the legal issues and factual information presented in this report were discussed with Treasury officials during our examination.

After your November 1 letter, your office asked that we also examine the Treasury Department's management of the Railroad Retirement Trust Funds during the 1985 debt ceiling crisis. As agreed with your office, this information will be provided in a separate report.

Unless you publicly announce the contents of this report earlier, we will withhold further distribution of it for 2 days, after which copies will be made available to other interested congressional committees and members; the Secretary of the Treasury; the Director, Office of Management and Budget; and other interested parties.

Sincerely yours,

Charles A. Bowsher
Comptroller General
of the United States

C o n t e n t s

	<u>Page</u>
APPENDIX	
I	LEGALITY OF SECRETARY OF THE TREASURY'S MANAGEMENT OF SOCIAL SECURITY TRUST FUNDS DURING THE 1985 DEBT CEILING CRISIS
	5
	Background
	5
	Discussion
	7
	Other questions addressed
	10
II	FACTUAL INFORMATION ON TREASURY'S MANAGEMENT OF SOCIAL SECURITY TRUST FUNDS DURING THE 1984 AND 1985 DEBT CEILING CRISES
	14
	Introduction
	14
	Results in brief
	14
	Scope and methodology
	15
	Treasury's normal Trust Fund investment practices
	16
	Normal practices followed in July and August 1985
	16
	Treasury departed from normal practices in September and October 1985
	17
	Treasury accelerated Trust Fund redemptions in November 1985
	19
	Treasury disinvested Trust Funds during previous debt limit crises
	20
	Possible interest losses to the Trust Funds
	21
	Summary
	21
<u>Tables</u>	
II.1	Status of the Social Security Trust Funds' Assets, July through November 13, 1985
	22
II.2	Social Security Trust Funds--Comparison of NTT Amounts Credited and Invested on the NTT Dates in Selected Months
	23
II.3	Analysis of Potential Trust Fund Certificates of Indebtedness That Would Have Been Issued and Redeemed During September to November 1985 Without a Debt Ceiling Problem
	24
II.4	Summary of Uninvested Normalized Tax Transfers as of November 13, 1985
	25

<u>Tables</u>		<u>Page</u>
II.5	Securities Redemptions in November 1985 to Meet Regular Social Security Benefit Payments	26
II.6	OASI and DI Trust Funds--Summary of Bond Redemptions, July-November 1985	27
II.7	OASI and DI Trust Funds--Bond Redemptions, July-November 1985	28
II.8	OASI and DI Trust Funds--Bond Redemptions During 1984	30

ABBREVIATIONS

CI	certificate of indebtedness
DI	Disability Insurance
NTT	normalized tax transfer
OASDI	Old Age, Survivors', and Disability Insurance
OASI	Old Age and Survivors' Insurance

LEGALITY OF SECRETARY OF THE TREASURY'S
MANAGEMENT OF SOCIAL SECURITY TRUST FUNDS
DURING THE 1985 DEBT CEILING CRISIS

This appendix addresses the legality of the Secretary of the Treasury's management of the Social Security Trust Funds¹ during the government's debt ceiling crisis this year. For the reasons indicated below, we conclude that, although some of the Secretary's actions appear in retrospect to have been in violation of the requirements of the Social Security Act, we cannot say the Secretary acted unreasonably given the extraordinary situation in which he was operating.

BACKGROUND

It must be understood that there are no Social Security Trust Funds in the sense that the term is normally used in the private sector. That is, there is no body of assets, derived from social security tax revenues, which is separately held and managed for the benefit of participants in the social security system. Instead, there are only accounts maintained on the books of the Treasury called Social Security Trust Funds.

In a normal month, on the first business day of the month, the Secretary of the Treasury, under subsection 201(a) of the Social Security Act, as amended, 42 U.S.C. § 401(a), transfers from the General Fund and credits to the Social Security Trust Funds an amount equivalent to the estimated payroll tax revenues which will be received that month. These funds, called the normalized tax transfer, are immediately invested in short-term Treasury securities. Social security benefits for the month are paid from the General Fund of the Treasury. On the benefit payment date, which is usually the third day of the month, a portion of the Treasury securities held by the Trust Funds are redeemed to reimburse the General Fund for social security benefits which are paid by electronic fund transfer on that date. Additional securities are redeemed 4 and 5 business days later to reimburse the General Fund for social security benefits which were paid by check on the benefit payment date. Actual payroll tax revenues during the month are deposited directly in the General Fund of the

¹In this opinion we shall refer to the Federal Old Age and Survivors' Insurance Trust Fund and the Federal Disability Insurance Trust Fund as the Social Security Trust Funds.

Treasury in order to keep it whole for the normalized tax transfer to the Trust Funds.

In months in which the normalized tax transfer is greater than the amount of social security benefits, the surplus remains invested in Treasury securities. Each June 30, any surplus for the year, after correcting for actual payroll taxes received, is converted to investment in long-term securities. In months in which the normalized tax transfer is less than the amount of social security benefits, the Secretary must redeem not only the securities purchased with that month's normalized tax transfer but also other short-term securities sold to the Trust Funds during the year to cover the excess payments. If there are insufficient short-term securities maturing the following June 30, he is forced to redeem long-term securities representing surpluses of prior years.

The Events of September,
October, and November

In September, October, and November 1985, there were some departures from the normal procedure. On September 3, the first business day of the month, the Secretary effected the normalized tax transfer by crediting the estimated payroll tax revenues for the month to the Trust Funds. However, because the Treasury Department was near the debt ceiling, the Secretary invested only a small amount of the transfer. Instead, the bulk of the credit representing the transfer was kept in a non-interest-bearing account. September 3 was also the September benefit payment date. To reimburse the General Fund of the Treasury for the electronic fund transfers that took place that day, the Secretary redeemed current-year securities, and, because these were insufficient to cover the full amount of the payments, some long-term securities held by the Trust Funds as well. Four and five business days later, to reimburse the General Fund for benefits paid by check, the Secretary redeemed additional long-term securities of the Trust Funds. During the month, as total Treasury borrowing fell below the debt ceiling, the Secretary invested most of the uninvested normalized tax transfer funds in short-term securities.

On October 1, the Secretary again made the normalized tax transfer by crediting the anticipated payroll tax revenues to the Trust Funds. He did not immediately invest the transferred credits because total Treasury borrowing was already at the debt limit. He redeemed securities held by the Trust Funds on October 3, the electronic fund transfer benefit

payment date, and, on the fourth and fifth business days after that date for check payments, to reimburse the General Fund for October social security benefits. Unlike September, however, the Secretary did not invest any of the uninvested normalized tax transfer funds later in the month because total Treasury borrowing did not drop below the debt limit.

On November 1, the Secretary again made the normalized tax transfer. As in September and October, the funds were credited to a non-interest-bearing account rather than being invested because Treasury borrowing was at the debt ceiling. November 1 was also the electronic fund transfer benefit payment date. Benefit checks were dated November 2. The Treasury Department estimated that it would have insufficient cash on November 1 to pay social security benefits and other government obligations. In order for these payments to be made, the Treasury needed to borrow money from the public, and in order to borrow the money, Treasury had to reduce its outstanding debt below the statutory limit. Therefore, on November 1 the Secretary redeemed \$9.613 billion of the Trust Funds' long-term securities, and \$1.9 billion of securities held by certain other government-managed trust funds, to permit public borrowing of about \$13 billion. On November 4, an additional \$4.181 billion of the Trust Funds' securities were redeemed, as well as securities held by the other trust funds, which allowed public borrowing of \$4.75 billion. Finally, on November 8 and 12 an additional \$715 million and \$266 million, respectively, of the Trust Funds' obligations were redeemed.

On November 14, when the Congress passed a temporary increase to the statutory debt limit, the Secretary was able to invest the Trust Funds' uninvested assets.

DISCUSSION

The Secretary of the Treasury was subject to two statutory obligations and a statutory constraint relevant to his management of the Social Security Trust Funds during September, October, and November of this year.

First, subsection 201(a) of the Social Security Act, as amended, 42 U.S.C. § 401(a), provides that the monthly normalized tax transfer "shall be invested by the Managing Trustee in the same manner and to the same extent as the other assets of the Trust Funds." Subsection 201(d), 42 U.S.C. § 401(d), requires the Secretary of the Treasury, as Managing Trustee of the Trust Funds, "to invest such portion of the Trust Funds as

is not, in his judgment, required to meet current withdrawals." The investments may be made only in interest-bearing obligations of the United States or obligations guaranteed by the United States.

Second, the Secretary has a statutory duty to pay social security benefits to those who are entitled to receive them. See title II of the Social Security Act, as amended, 42 U.S.C. §§ 401-433.

The constraint lies against the Secretary's authority to borrow money on the credit of the United States. The Constitution grants the power to borrow money to the Congress. U.S. Const., art. I, § 8, cl. 2. While the Congress has, by statute, authorized the Secretary to borrow money on the credit of the United States, it has limited the authority for most borrowing by a debt ceiling. During September, October, and the relevant period of November of this year, that limit was \$1,823,800,000,000. See 31 U.S.C. § 3101(b). Investment of the Social Security Trust Funds' assets count against this limit. Section 201(d), supra.

There is no inherent conflict between these statutory obligations. As long as there are adequate funds in the cash account through which the government conducts all cash transactions, both obligations can be met. Funds in the account can be used to pay social security benefits and, if necessary, to reduce the government debt held by the public so that the Trust Funds' assets can be invested without exceeding the debt ceiling. On the other hand, if there are not sufficient funds in the cash account, then both obligations cannot be fully met, and the Secretary is forced to choose the manner in which he will satisfy them.

An examination of the data shows that, although there were insufficient funds in the Treasury cash account in September, October, and November for the Secretary to fully satisfy both obligations, he could have done more than he did to invest the Trust Funds' assets while assuring that all benefit payments were made.

For example, on September 3, Treasury had a sufficient operating balance in its cash account and available borrowing authority under the debt limit to permit the Secretary to pay social security benefits that day and still invest substantially more of the normalized tax transfer than he did. Further, it appears that the Secretary could have continued to meet the government's obligations throughout the month and still have kept a larger proportion of the Trust Funds' assets

invested for a longer period than he did. By the end of the month it should have been possible to have invested the entire normalized tax transfer amount.

Further, given the actual events of September, the Secretary could have kept a larger amount of the Trust Funds' assets invested for a longer period in October than he did and still have paid benefits. Admittedly, by October 1, the Treasury was already at the debt ceiling. There was a sufficient operating balance in its cash account, however, to permit the Secretary to redeem outstanding publicly held securities, thus permitting investment of some of the normalized tax transfer. Although these investments soon would have had to be redeemed to cover benefit payments, in our opinion the Secretary did not keep the Trust Funds' assets invested for as long a time and in as large amount as he could have.

The November situation was more complex. On November 1, there was no available borrowing authority, and Treasury's cash balance was insufficient for the Secretary either to pay benefits or to invest any part of the normalized tax transfer. The Secretary, therefore, could not meet both of his statutory obligations within the constraint imposed. He elected to pay the social security benefits. To do this, he needed first to ignore his obligation to invest the normalized tax transfer, which he did. Second, he needed to redeem approximately \$5 billion of the Trust Funds' existing investments in order to borrow enough money to bring the balance in the cash account to approximately \$6.9 billion, the amount needed to make the benefit payments. In fact, however, the Secretary redeemed \$9.6 billion of the Trust Funds' investments on November 1, more than appeared to be necessary on that day.

During the period of November 4 to 12, the Secretary redeemed additional Trust Funds' investments in order to borrow additional funds to cover November benefits paid by check. The total redemptions during November 1 to 12 were about the same as the total benefits paid. However, it appears that the redemptions occurred at a faster rate than necessary to make the benefit payments.

In sum, it appears, on the basis of the information now available, that the Secretary redeemed or failed to invest the Trust Funds' assets in amounts and for periods of time greater than absolutely necessary to pay social security benefits. However, this is a judgment reached only with the benefit of hindsight. The Secretary was required to act in a complex and

fluid situation, without the benefit of all of the information now available.² Further, the Secretary had many other duties to carry out, including managing the government's finances and investing assets of and making payments from other government-managed trust funds. Under all the circumstances involved, we conclude that he did not act unreasonably.

OTHER QUESTIONS ADDRESSED

Other questions raised by Treasury's actions are discussed below.

Question 1: Does Treasury have authority to restore interest that may have been lost because the Secretary did not invest the entire normalized tax transfers in September, October, and November?

Aside from providing for the normalized tax transfer, subsection 201(a) of the Social Security Act, 42 U.S.C. § 401(a), provides that the Trust Funds shall pay to the General Fund the difference between the interest they earn from the invested normalized tax transfer and the interest they would have earned if they had invested payroll tax revenues as they were received during the month.

Interest earned on the Trust Funds' investments is credited to the Trust Funds every 6 months, in June and December. At the same time, the Trust Funds pay to the General Fund the interest required by subsection 201(a). In December 1985, Treasury should be able to restore interest lost due to noninvestment of the normalized tax transfers in September, October, and November, by offsetting that amount against the interest the Trust Funds owe to Treasury under subsection 201(a) for the months in which the transfer was invested.

²Because of the complexity of Treasury operations, the Secretary is unable to know at any given time the exact operating balance in the cash account or the exact amount of debt. Much of the information he has is based on estimates. To provide a safety margin against inadvertent statutory violations, it is Treasury policy to try to maintain a minimum cash balance and to leave a small amount of debt unused. We find these procedures to be reasonable.

Question 2: Did the continued deposit of payroll tax revenues in the General Fund, the failure to make the normalized tax transfer in advance each month, and the subsequent cancellation of long-term bonds, together result in the Trust Funds being used to finance general government expenses in violation of the intent and requirements of the Social Security Act?

The normalized tax transfer procedure established by subsection 201(a) of the Social Security Act, as amended, contemplates a transfer to the Trust Funds, in advance at the beginning of the month, of the estimated amount of the payroll tax revenues which are expected to be received that month. The actual payroll taxes are deposited as they are received in the General Fund of the Treasury rather than in the Trust Funds because the Trust Funds have already been credited with that revenue. As indicated above, the normalized tax transfers for September, October, and November were made by the Secretary. However, he did not fully invest them. Therefore, there was nothing improper in payroll tax revenues being used to meet general obligations of the government.

However, not all of the withholding from investment and securities redemptions in September, October, and November were necessary to meet social security benefit payments. To the extent that the Trust Funds' assets were kept uninvested to permit the payment of other government obligations or to restore cash balances, the Trust Funds were being used contrary to the statutory scheme to sustain the government's general operations.

Question 3: By not investing the normalized tax transfer and by redeeming long-term obligations to finance social security benefits, did the Secretary, in effect, raise the debt ceiling without an act of Congress? Does the executive branch have the constitutional and statutory authority to act this way?

Article I, section 8, clause 2, of the Constitution authorizes the Congress "To borrow Money on the credit of the United States." The Congress has delegated this authority to the Secretary of the Treasury in chapter 31 of title 31, United States Code, subject to the limitation in 31 U.S.C. § 3101(b). The debt subject to the limit is defined as "[t]he face amount of obligations issued under [chapter 31 of title 31] and the face amount of obligations whose principal and interest are guaranteed by the United States Government * * *." *Id.* Subsection 201(d) of the Social Security Act provides that securities issued to the Trust Funds are issued under chapter 31 of title 31, and therefore, they are counted toward the debt limit.

There are two ways of looking at the Secretary's failure to invest the normalized tax transfer and his redemption of long-term obligations. Debt subject to the statutory limit consists of securities held by the public and securities held by government agencies, including the Trust Funds. The Trust Funds' transactions in September, October, and November had the effect of reducing the portion of the debt held by government agencies and increasing the portion held by the public. However, they did not increase the total amount of outstanding debt subject to the statutory limit. Therefore, it may be said that the Secretary did not violate the statutory debt limit and did not usurp the congressional power under the Constitution to borrow. Under this view the measure of debt subject to the debt limit is determined solely by the amount of applicable securities outstanding.

A distinction must be recognized, however, between timely actions by the Secretary regarding amounts up to the total of social security benefits paid and those of his actions regarding amounts which exceeded requirements to meet social security benefit payments. Timely disinvestment or failure to invest (that is, such actions taken in proper amounts to finance imminent social security payments due) were authorized and proper, as the Trust Funds are not entitled to interest earnings on the amounts involved. On the other hand, excessive amounts disinvested or not invested (that is, amounts over and above those needed to meet social security payments) may be viewed as having given rise to exceeding the debt ceiling where the excess amounts when added to the debt ceiling securities outstanding totaled more than the authorized ceiling.

Conceptually, the second analysis is more satisfying--excessive amounts disinvested or not invested should be added to the government's outstanding debt, as if those amounts were, in fact, a debt to the Trust Funds. Yet, given the necessity for Treasury's operations to be on the basis of estimates and in light of the grave consequences attendant to the government defaulting on its obligations, it does not appear that the Secretary can reasonably be said to have acted improperly in September, October, and November, despite the facts as we now know them to have been.

Question 4: Has the Secretary breached his duty as fiduciary by sacrificing the interests of the Trust Funds for the purpose of minimizing general revenue interest obligations to the Trust Funds?

First, we note that by statute neither the Secretary nor any of the other trustees of the Trust Funds are fiduciaries. 42 U.S.C. § 401(c). Rather, the duties of the Secretary as Managing Trustee are set by the Social Security Act.

Moreover, there is no evidence that the Secretary redeemed securities, or failed to invest funds, for the purpose of avoiding General Fund interest payments to the Trust Funds.

FACTUAL INFORMATION ON TREASURY'S
MANAGEMENT OF SOCIAL SECURITY TRUST FUNDS
DURING THE 1984 AND 1985 DEBT CEILING CRISES

INTRODUCTION

On November 1, 1985, the Chairman, House Ways and Means Subcommittee on Social Security, requested that we investigate the Department of the Treasury's handling of the Social Security Trust Funds--Federal Old Age and Survivors' Insurance (OASI) Trust Fund and Federal Disability Insurance (DI) Trust Fund--during the past several months and in October 1984. Many of the issues raised were of a legal nature regarding the Funds' investment and disinvestment; our legal opinion on those issues is contained in appendix I. This appendix discusses factual information on the Department's actions in the context of the statutory debt limit. Specifically, the Chairman asked us to determine:

- What actions Treasury took with respect to the Social Security Trust Funds in October 1984 and in August, September, October, and November 1985.
- How much of estimated monthly tax receipts were invested in interest-bearing securities held by the Trust Funds on the first day of each of these months to finance benefits.
- What long-term bonds were redeemed in each of these months to finance benefit payments and whether these bonds would have been otherwise redeemed had there been no possibility of the federal government reaching the debt limit in any of those months.
- Whether the Treasury has routinely drawn upon long-term reserves of the Trust Funds to generate additional borrowing authority and thus avoid hitting the debt ceiling.

RESULTS IN BRIEF

In summary, we found that:

- During September, October, and the first 13 days of November 1985, Treasury did not invest \$28.2 billion in accumulated normalized tax transfers credited to the

Trust Funds at the beginning of those months, due to the statutory debt ceiling having been reached on September 3, 1985. With the \$80 billion temporary increase in the debt ceiling enacted on November 14, 1985, Treasury immediately acted to invest all of the \$28.2 billion, initially, in short-term interest-bearing certificates of indebtedness maturing on June 30, 1986. However, as required by the temporary debt ceiling legislation, Treasury subsequently reinstated \$18.512 million of this amount in long-term bonds carrying their original interest rates and maturity dates.

- During the same September-November 1985 period, Treasury redeemed \$27.9 billion in long-term, special-issue bonds bearing interest rates ranging from 8-3/4 to 10-3/4 percent, with June 30 maturity dates ranging from 1986 to 2000. The Trust Funds' highest interest-bearing long-term securities, at 13-3/4 percent and totaling \$5.2 billion, were not redeemed. The resulting borrowing authority below the debt ceiling gained by these redemptions was used to generate operating cash in Treasury's General Fund to continue government operations, including paying social security benefits.
- In the absence of a limit on Treasury's borrowing authority, none of the long-term bonds would have had to be redeemed as Treasury would have been able to follow its normal Trust Fund investment/redemption practices throughout September, October, and November 1985.
- During September and October 1984, Treasury redeemed high-interest-bearing, long-term, special-issue Treasury bonds held by the Trust Funds to obtain borrowing authority under the statutory debt ceiling so that social security benefit payments could be made.
- Treasury's actions in September and October 1985--redeeming long-term securities held by the Trust Funds to generate borrowing authority under the debt limit--were similar to those in past debt ceiling crises. However, the accelerated redemption of securities in November 1985 appears unprecedented.

SCOPE AND METHODOLOGY

In conducting our review within the time frame provided in the Chairman's letter, we concentrated primarily on Treasury's

actions during August through November 15, 1985. We met with Treasury officials in the Office of the Assistant General Counsel for Banking and Finance, Office of the Fiscal Assistant Secretary, and Financial Management Service, to obtain specific data and documentation, and we reviewed Trust Fund investment ledgers. We also reviewed recent Treasury testimony and other information contributed for the public record concerning Treasury's procedures and actions. Our findings represent a distillation of the information obtained directly from Treasury and additional information provided by other sources.

TREASURY'S NORMAL TRUST FUND
INVESTMENT PRACTICES

Treasury's practice regarding the Social Security (OASI and DI) Trust Funds on June 30 of each investment year (July 1 to June 30) is to convert any year-end surplus funds into long-term, special-issue, nonmarketable Treasury bonds with varying maturities of 1 to 15 years. These surplus funds are generally held during the year in short-term securities called certificates of indebtedness (CIs) having a maturity date of June 30. Therefore, all of the assets of the Trust Funds as of June 30 are invested in Treasury bonds.

As table II.1 shows, the total assets of the Trust Funds as of July 1, 1985, were \$36,883 million, all of which were in long-term, special-issue bonds.

At the beginning of each month, based on procedures adopted in the 1983 Amendments to the Social Security Act, the Treasury Department advances to the Trust Fund receipt accounts an amount equal to the estimated Social Security payroll tax (FICA and SECA)¹ receipts for that month. This amount, called a normalized tax transfer (NTT), is an advance that normally is immediately invested in CIs. The interest earned on this advance must be repaid to the Treasury, and the actual (net) interest earned by the Trust Funds is that which would be earned by investing actual tax receipts as received during the month.

NORMAL PRACTICES FOLLOWED
IN JULY AND AUGUST 1985

On July 1, 1985, an NTT amount of \$13,785 million was credited to the Trust Funds and immediately invested in CIs.

¹Federal Insurance Contributions Act and Self-Employment Contributions Act.

These and other certificates were redeemed during the month to meet required disbursements for benefit payments and expenses. During July the short-term certificates as well as some 10-3/8-percent special-issue Treasury bonds, all with maturity dates of June 30, 1986, were redeemed to finance disbursements. In this case about \$638 million in bonds were redeemed in addition to CIs; however, this was not unusual because bonds and CIs maturing on the same date are treated identically for redemption purposes. Treasury would normally redeem the lowest interest rate first for these "short-term" issues.² Treasury's actions during July left securities balances as of July 31 of \$1,564 million in CIs and \$36,244 million in bonds (see table II.1).

In August 1985 the normalized tax transfer was credited to the Trust Funds in the normal way and amounted to \$13,968 million. This amount was fully invested in CIs. During the month \$14,680 million in CIs and \$1,808 million in 10-3/8-percent bonds maturing on June 30, 1986, were redeemed to pay benefits and expenses. Thus, in terms of Trust Fund investment/redemption procedures, August, like July, could be considered a normal month. At the end of August the total assets of the Trust Funds were \$37,355 million; \$37,196 million of this total was invested. Special-issue bonds totaled \$34,436 million. (See table II.1.)

TREASURY DEPARTED FROM NORMAL
PRACTICES IN SEPTEMBER AND OCTOBER 1985

At the beginning of September, the Treasury General Fund held an operating cash balance of \$11,841 million, and the public debt subject to the statutory limit was within \$5,113 million of the debt limit. Therefore, on the first business day, September 3, Treasury credited the Trust Funds with the NTT (\$15,128 million); however, most of this amount was not immediately invested because of the statutory debt limit (see table II.2). By the end of the first business day in September, the public debt was within \$5 million of the debt limit.

²That is, all Trust Fund securities maturing on June 30, 1986, regardless of whether they are CIs or bonds are considered "short-term" securities as this term is used in appendix I. Whereas all bonds could be considered long-term, in appendix I "long-term" refers to all bonds held by the Trust Funds except those maturing at the end of the current investment year (i.e., June 30, 1986).

Treasury met benefit payments from the General Fund, and this was followed by redemption of available CIs and bonds. In this case, Treasury redeemed long-term bonds--specifically, 10-3/8-percent bonds maturing in 1987-88 in an amount of \$6,901 million on September 3, 9, 19, and 30 (see tables II.6 and II.7). If Treasury had sufficient borrowing authority below the debt ceiling to fully invest the September NTT at the beginning of the month, long-term bonds would not have had to be redeemed in September. During September total redemptions of Trust Funds securities were \$16,110 million. This amount was \$4,447 million less than the total CIs that would have been available to cover these redemptions, had Treasury been able to follow its normal NTT investment procedures (see table II.3).

As borrowing authority became available under the debt limit during September, Treasury moved to invest the NTT amount, and by the end of September, most of the NTT amount was so invested. Available CIs at the end of September totaled \$8,875 million. The uninvested NTT amount was \$2,348 million. Trust Funds investments totaled \$36,410 million. (See tables II.1 and II.4.)

On October 1, 1985, the Treasury General Fund held a beginning operating cash balance of \$17,060 million, and the public debt subject to the statutory limit was still within \$5 million of the debt limit. Because October 1 was the first business day of the month, \$12,783 million--the NTT amount--was credited to the Trust Funds, but unlike September, none of this amount was invested in CIs because of the debt limit (see table II.4). Treasury again met required benefit payments from its available cash, and this was followed by redemption of available CIs (the \$8,875 million remaining from September) and bonds. On October 9, 10, 15, 19, 20, 29, and 31, Treasury redeemed \$4,558 million of 10-3/8-percent bonds maturing in 1989 to 1991. Also redeemed, on October 10 and 31, were \$212 million of 10-3/4-percent bonds maturing in 1990.

During October, total redemptions of Trust Fund securities totaled \$16,510 million. This amount, however, was \$3,907 million less than the total CIs that would have been available for redemption had Treasury been able to follow its normal NTT investment procedures in September and October. (See table II.3.)

Because Treasury did not invest any of the NTT during October, the uninvested portion of the Trust Funds' assets grew significantly. At the end of October, the uninvested NTT portion of the Trust Funds was \$15,131 million. The invested

portion of the Trust Funds had decreased to \$23,087 million. (See tables II.1 and II.4.)

TREASURY ACCELERATED TRUST FUND
REDEMPTIONS IN NOVEMBER 1985

The latter part of October saw the Treasury General Fund cash position continuing to worsen. It was expected that sufficient cash would not be available on November 1 to meet the government's obligations for that day, including \$6,899 million required to meet social security payments by electronic fund transfer.

Treasury projected that it needed to borrow \$13 billion on November 1 to meet its obligations and restore an adequate cash balance. After informing the Congress on October 22, Treasury proceeded on November 1 to disinvest securities of several trust funds, including the Social Security Trust Funds, to create sufficient borrowing authority below the debt ceiling. Accordingly, it redeemed \$9,613 million of the Social Security Trust Funds' long-term securities on November 1. This was followed by additional redemptions of \$4,181 million on November 4, \$715 million on November 8, and \$266 million on November 12. This disinvestment of the Trust Funds represented an acceleration of redemptions and was a departure from the normal pattern of redemptions to meet social security payments. The normal pattern of redemptions for November, in the absence of a debt ceiling crisis, is compared to Treasury's actual redemptions in table II.5.³

On November 1, the NTT amount of \$13,088 million was credited to the Trust Funds but, as in October, remained totally uninvested until November 14, when the debt ceiling was temporarily raised. Thus, the uninvested portion of the Trust Funds again increased significantly, and as of November 13 the total uninvested portion of the NTT was \$28,219 million. The invested portion of the Trust Funds was \$9,098 million. (See table II.1.)

³It should be noted that, for the November redemptions, Treasury departed from its normal redemption procedures for long-term bonds. Normally, Treasury redeems the earliest maturity date first and then within that maturity date, redeems the lowest interest rate first. In November, Treasury redeemed securities with the lowest interest rate first, regardless of maturity date. This was done to minimize the impact (i.e., potential interest loss) to the Trust Funds.

To cover the regular social security benefit payments in November, Treasury redeemed \$13,742 million of long-term bonds maturing in 1991 through 2000 and carrying interest rates ranging from 8-3/4 to 10-3/4 percent. None of the Trust Funds' highest interest-bearing, long-term securities, at 13-3/4 percent and totaling \$5,208 million, were redeemed during November or at any earlier time during the 1985 debt ceiling crisis. Also, absent the debt ceiling crisis, none of the other long-term bonds would have had to be redeemed in November if Treasury had been able to follow its normal NTT investment procedures in September, October, and November (see table II.3).

Tables II.6 and II.7 provide additional data on Trust Fund long-term bond redemptions between July and November 1985.

TREASURY DISINVESTED TRUST FUNDS
DURING PREVIOUS DEBT LIMIT CRISES

The practices in which the Treasury engaged in September and October 1985 are not without precedent. Actions that the Treasury took in 1983 and 1984 are discussed in The Budget of the U.S. Government for Fiscal Year 1986, Special Analysis E. It is stated that lack of borrowing authority prevented Treasury from fully investing NTT amounts on the first of the month in November 1983 and in May, June, and July 1984. In addition, our analysis of Treasury's actions during the September-October 1984 debt ceiling crisis shows that the NTT was not fully invested on the first business days of either month.

In September 1984, the NTT amount credited to the Trust Funds was \$13,575 million, \$5,658 million of which was invested on the first business day, September 4. On October 1, none of the NTT amount of \$11,561 million was invested.

During the September 6-October 12 period, Treasury redeemed 13-3/4-percent long-term bonds with maturity dates ranging from 1988 through 1990. Also redeemed were 10-3/4-percent bonds with maturity dates of 1986 through 1991. Also on August 31, 1984, 13-3/4-percent bonds were redeemed to finance social security payments by electronic funds transfer made on that date.⁴ This took place on August 31 because the normal payment date of

⁴The redemption of the Trust Funds' 13-3/4-percent securities followed the Treasury's normal procedure of redeeming the earliest available maturity first.

September 3 fell on a holiday (Labor Day), and there were insufficient CIs available to cover the required redemption. Thus, during the period August 31 through October 12, 1984, \$9,854 million in long-term bonds held by the Trust Funds were redeemed. Specific information on these bond redemptions is given in table II.8.

POSSIBLE INTEREST LOSSES TO THE TRUST FUNDS

We did not attempt, as a part of this review, to determine the extent of possible interest losses to the Trust Funds. Based on the information available, it appears that no interest losses should result from Treasury's noninvestment of the NTT during September through November 1985. However, losses may result from the earlier than normal redemption of the Trust Funds' long-term securities during this period. Depending on changes in interest rates, long-term bond redemptions during September through November (and in earlier years) may result in losses or gains to the Trust Funds compared to a hypothetical situation where debt limit considerations are absent.

Our office has recently initiated a government-wide review of trust fund financial management activities, the results of which should provide a basis for assessing possible interest gains or losses to the Trust Funds.

SUMMARY

In reviewing Treasury's actions during the current debt ceiling crisis, we found that NTT amounts were not fully invested at the beginning of September, October, and November 1985. Instead, Treasury redeemed the Trust Funds' short- and long-term securities to meet social security payments. Our analysis shows that, if adequate borrowing authority under the statutory debt limit had been available during September through November 13, it would not have been necessary to redeem any of the Trust Funds' long-term securities. We also found that the noninvestment of NTT amounts in September and October was not unprecedented--similar actions were taken in 1983 and 1984. The actions of November 1985, however, appear to have no precedent.

Table 11.1: Status of the Social Security Trust Funds^a
Assets, July through November 13, 1985

(dollars in thousands)

	July 1 ^b	July 31	August 31	September 30	October 31	November 13 ^d
Certificates of Indebtedness						
OASI	\$ 0	\$ 1,404,367	\$ 2,634,514	\$ 8,209,540	\$ 237,408	\$ 0
DI	0	159,461	124,932	665,468	84,192	74,758
OASDI	0	1,563,828	2,759,466	8,875,008	321,600	74,758
Bonds						
OASI	30,856,517	30,426,189	28,799,415	22,757,963	18,772,697	6,529,042
DI	6,026,195	5,818,306	5,636,735	4,777,159	3,992,501	2,694,046
OASDI	36,882,712	36,244,495	34,436,150	27,535,122	22,765,198	9,023,088
Total Investments	36,882,712	37,808,323	37,195,616	36,410,130	23,086,798	9,097,846
Uninvested amounts ^c	d	452,508	159,318	2,348,021	15,131,021	28,219,021
Total assets	\$36,882,712	\$38,260,831	\$37,354,934	\$38,758,151	\$38,217,819	\$37,316,867
	*****	*****	*****	*****	*****	*****

^aStatus before transacting business on July 1, 1985.

^bStatus before enactment of legislation temporarily increasing the statutory public debt limit.

^cJuly and August amounts were tax receipts in transit at the end of these months.
September-November amounts resulted from uninvested normalized tax transfers.

^dData were not available.

Table II.2: Social Security Trust
Funds--Comparison of NTT Amounts Credited
and Invested on the NTT Dates
in Selected Months

(dollars in thousands)

<u>NTT</u> <u>date</u> ^a	<u>NTT</u> <u>amount</u> <u>credited</u>	<u>NTT</u> <u>amount</u> <u>invested</u> <u>on NTT</u> <u>date</u>
9-4-84	\$13,575,000	\$ 5,658,000
10-1-84	11,561,000	0
11-1-84	12,037,000	12,037,000
7-1-85	13,785,000	13,785,000
8-1-85	13,968,000	13,968,000
9-3-85	15,128,000	981,000
10-1-85	12,783,000	0
11-1-85	13,098,000	0

^aFirst business day of the month.

Table II.3: Analysis of Potential Trust Fund
Certificates of Indebtedness That Would Have
Been Issued and Redeemed During September
to November 1985 Without a Debt Ceiling Problem

(dollars in thousands)

<u>Actual CIs at beginning of September 1985:</u>	<u>\$ 2,759,466</u>
NTT for September	15,128,000
Actual CI investments of other receipts in September	<u>2,669,352</u>
Total potential CIs to meet all redemptions in September	20,556,818
Total actual redemptions of securities in September	<u>(16,109,865)</u>
<u>Potential CI balance at end of September 1985:</u>	<u>4,446,953</u>
NTT for October	12,783,000
Actual CI investments of other receipts in October	<u>3,186,775</u>
Total potential CIs to meet all redemptions in October	20,416,728
Total actual redemptions of securities in October	<u>(16,510,107)</u>
<u>Potential CI balance at end of October 1985:</u>	<u>3,906,621</u>
NTT for November	13,088,000
Actual CI investments of other receipts in early November	<u>785,653</u>
Total potential CIs to meet all redemptions in early November	17,780,274
Total actual redemptions of securities in early November	<u>(14,690,413)</u>
<u>Potential CI balance as of November 13, 1985:</u>	<u>\$ 3,089,861</u>

Table II.4: Summary of Uninvested Normalized
Tax Transfers as of November 13, 1985^a

(dollars in thousands)

<u>Month</u>	<u>Trust fund</u>	<u>Normalized tax transfers</u>	<u>Uninvested portion</u>	<u>Cumulativ uninveste amounts</u>
September 1985	OASI	\$13,803,000	\$ 2,142,546	
	DI	<u>1,325,000</u>	<u>205,475</u>	
		15,128,000	2,348,021	\$ 2,348,021
October 1985	OASI	11,662,000	11,662,000	
	DI	<u>1,121,000</u>	<u>1,121,000</u>	
		12,783,000	12,783,000	15,131,021
November 1985	OASI	11,940,000	11,940,000	
	DI	<u>1,148,000</u>	<u>1,148,000</u>	
		13,088,000	13,088,000	28,219,021
Totals	OASI	37,405,000	25,744,546	
	DI	<u>3,594,000</u>	<u>2,474,475</u>	
		<u>\$40,999,000</u>	<u>\$28,219,021</u>	

^aBefore enactment of the emergency legislation temporarily increasing the statutory public debt limit.

Table 11.5: Securities Redemptions in November 1985
to Meet Regular Social Security Benefit Payments

(dollars in millions)

Description	Business dates							Total
	Nov. 1	Nov. 4	Nov. 5	Nov. 6	Nov. 7	Nov. 8	Nov. 12	
Actual redemptions	\$9,612.3	\$4,181.3	\$0	\$0	\$0	\$ 714.7	\$266.1	\$14,774.6
Planned redemptions without a debt ceiling crisis	<u>5,899.0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>4,816.0</u>	<u>3,210.0</u>	<u>0</u>	<u>14,925.0</u>
Differences (actual as compared to planned)	\$2,713.3	\$4,181.3	\$0	\$0	\$-4,816.0	\$-2,495.3	\$266.1	\$ -150.4
	*****	*****	**	. **	*****	*****	*****	*****

Table 11.6: OASI and DI Trust Funds--
Summary of Bond Redemptions, July-November 1985

(dollars in thousands)

	<u>8-3/4%</u>	<u>9-3/4%</u>	<u>10-3/8%</u>	<u>10-5/4%</u>	<u>15-3/4%</u>	<u>Totals</u>
Beginning balances, July 1, 1985 ^A	<u>\$ 386,756</u>	<u>\$ 766,286</u>	<u>\$21,615,774</u>	<u>\$ 8,905,880</u>	<u>\$ 5,208,016</u>	<u>\$ 36,882,712</u>
Redemptions:						
July	\$ 0	\$ 0	\$ (638,217)	\$ 0	\$ 0	\$ (638,217)
August	0	0	(1,808,345)	0	0	(1,808,345)
September	0	0	(6,901,028)	0	0	(6,901,028)
October	0	0	(4,557,576)	(212,348)	0	(4,769,924)
November	<u>(386,756)</u>	<u>(766,286)</u>	<u>(6,791,034)</u>	<u>(5,798,034)</u>	<u>0</u>	<u>(13,742,110)</u>
Total redemptions	<u>(386,756)</u>	<u>(766,286)</u>	<u>20,696,200</u>	<u>6,010,382</u>	<u>0</u>	<u>(27,859,624)</u>
Ending balances ^B	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 919,574</u>	<u>\$ 2,895,498</u>	<u>\$ 5,208,016</u>	<u>\$ 9,023,088</u>
	*****	*****	*****	*****	*****	*****

^ABalances before transacting business on July 1.

^BBalances before enactment of legislation temporarily increasing the statutory public debt limit on November 14.

Table 11.7: OASI and DI Trust Funds--
Bond Redemptions, July-November 1985

(dollars in thousands)

Date redeemed		Maturity date	8-3/4%	9-3/4%	10-3/8%	10-3/4%	13-3/4%
<u>OASI:</u>							
July	2	6/30/86			\$ 39,894		
	5	6/30/86			90,443		
	8	6/30/86			165,971		
	31	6/30/86			134,020		
August	2	6/30/86			1,626,774		
September	3	6/30/87			2,057,102		
	3	6/30/88			1,420,717		
	9	6/30/88			636,384		
	9	6/30/89			1,860,100		
	30	6/30/89			67,149		
October	9	6/30/89			129,892		
	9	6/30/90			628,021		
	10	6/30/90			1,429,080		
	10	6/30/91			1,392,518		
	10	6/30/91			93		
	15	6/30/91			324,628		
	29	6/30/91			5		
	31	6/30/91			39,641		
	31	6/30/91			16,100		
	31	6/30/91			25,328		
November	1	6/30/91			67,032		
	1	6/30/92			565,186		
	1	6/30/93			565,186		
	1	6/30/94			565,186		
	1	6/30/95			565,186		
	1	6/30/96			565,186		
	1	6/30/97			565,186		
	1	6/30/98			565,186		
	1	6/30/99			565,186		
	1	6/30/00			2,057,101		
	1	6/30/92				\$1,022,231	
	1	6/30/93				801,552	
	4	6/30/93				3,710	
	4	6/30/93				216,969	
	4	6/30/94				1,022,231	
	4	6/30/95				1,022,231	
	4	6/30/96				822,013	
	8	6/30/96				200,218	
	8	6/30/97				420,770	
	12	6/30/97				266,109	
Total OASI			\$ 0	\$ 0	\$18,729,441	\$5,798,034	\$ 0

Table 11.7 (continued)

Date redeemed		Maturity date	8-3/4%	9-3/4%	10-3/8%	10-3/4%	13-3/4%
DI:							
July	2	6/30/86			\$ 16,055		
	11	6/30/86			26,556		
	13	6/30/86			145,918		
	31	6/30/86			19,360		
August	2	6/30/86			181,571		
September	3	6/30/87			389,460		
	3	6/30/88			124,701		
	9	6/30/88			264,758		
	9	6/30/89			80,654		
	19	6/30/89			3		
October	9	6/30/89			308,802		
	9	6/30/90			79,108		
	10	6/30/90			98,003		
	10	6/30/90				\$ 195,517	
	20	6/30/91			76,381		
	31	6/30/90				16,831	
	31	6/30/91			10,016		
November	1	6/30/93	\$ 47,479				
	1	6/30/93		\$ 142,337			
	1	6/30/94		142,336			
	1	6/30/94	339,277				
	1	6/30/95		150,042			
	1	6/30/95		331,571			
	4	6/30/91			15,106		
	4	6/30/92			47,466		
	8	6/30/92			54,037		
	8	6/30/93			28,804		
Total DI			<u>386,756</u>	<u>766,286</u>	<u>1,966,755</u>	<u>212,348</u>	<u>0</u>
Total OASI and DI			<u>\$386,756</u> *****	<u>\$766,286</u> *****	<u>\$20,696,200</u> *****	<u>\$6,010,382</u> *****	<u>\$ 0</u> *****

Appendix III



THE SECRETARY OF THE TREASURY
WASHINGTON

October 22, 1985

Dear Jim:

As you participate in the conference on H.J. Res. 372 to increase the debt limit, I want to bring you up to date on where we stand and what actions Treasury will and will not take. We find ourselves in a position where continued Congressional inaction has moved the Treasury's position from sound financial management to unnecessary crisis management. I hope that a full explanation of our projections and intentions will allow responsible action to avoid costly continuation of this unseemly situation. By so acting, the United States will once again be able to raise funds to meet its lawful obligations without engaging in activities that erode confidence in our financial system.

Contrary to some assertions, Treasury's cash and debt projections and other information provided to the Congress since early September have been very accurate. In testimony on September 10, Treasury informed Congress that failure to pass a debt limit extension would result in our (1) reaching the debt ceiling and (2) becoming unable to invest fully several trust funds starting on September 30, with a consequent loss of interest to those funds. In a series of letters starting September 25, we warned Congress that our cash balances would be virtually exhausted on October 7, reaching a zero or negative balance on October 8. The testimony and letters predicted exactly what actually happened. In those same letters, we stated our strong reluctance to adopt the suggestion of Congressional staff that we use the Federal Financing Bank's non-debt-limit borrowing authority, calling such an action "unprecedented and questionable." We made clear, also, that if the Congress failed to act on the debt ceiling, we would have to choose between the FFB option and an unprecedented United States government default. Faced with Congressional inaction and the prospect of certain default on October 9, we used \$5 billion of the FFB authority.

We have taken every action ever used by this Department to raise cash within the debt limit. Moreover, we have taken the additional step of using the FFB's borrowing authority to avoid default. These actions have not been without costs. Since September, the failure of Congress to increase the debt limit has resulted in non-investment of trust funds, costly delays of auctions, and uncertainty throughout the capital markets. Over \$50 billion of financing that would otherwise have taken place over several months beginning in September is now confronting the markets. The uncertainty and delay will likely cost the American taxpayer millions of dollars.

Our current cash projections indicate that even if we use the remaining \$10 billion FFB borrowing authority, we will have a negative balance on November 1, widening to a negative balance of over \$5 billion by November 4. I intend to use the FFB borrowing authority, again reluctantly. But you should be aware that, subject to estimating error, it cannot get us through November 1. The negative numbers starting on November 4, moreover, are so large as to be outside the margin of error.

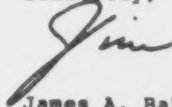
Some Members of Congress have suggested that, in order to provide Congress with yet more time, we should take the further extraordinary step of disinvesting trust funds (social security, military retirement, civil service retirement, and railroad retirement) in advance of payment of benefits to permit payment of those benefits starting November 1. (This option was not available on October 8, as October benefits had already been paid.) Taking this action will result in additional interest loss to the funds and further frustration of our financing schedule. Moreover, it may raise questions in the minds of present and future recipients of trust fund benefits--principally pensioners--about why they have become involved in the debt limit process. Nevertheless, having discussed this matter with the President and the Attorney General, we are reluctantly prepared to take this action on October 31 if Congress once again fails to act to resolve the debt limit impasse.

It is essential that Congress recognize that, even if trust funds were disinvested to avoid a November 1 default, we would certainly default on November 15 unless Congress acted before then to increase the debt limit. That default, which would involve reneging on the principal and interest of United States securities held by both Americans and foreigners, would have swift and severe domestic and international repercussions. No longer would investors view United States securities as riskfree, and a substantial financing price would have to be paid. Any increase in the benchmark Treasury rate would probably adversely affect general interest rates, with negative effects on both the deficit and the economy.

I have spent the past week reviewing the known legal and practical options and have concluded that there are no means available to avoid default that would not be a stark evasion of the debt limit statute--with the possible exception of the sale of United States gold holdings. The President and I are not prepared to take that step because it would undercut confidence here and abroad based on the widespread belief that the gold reserve is the foundation of our financial system, and because the Congress clearly has the power to prevent a default by assuming its responsibility with respect to the debt limit.

I sincerely hope you will take prompt action to avoid further exacerbation of this unnecessary and unfortunate situation.

Sincerely,



James A. Baker, III

The Honorable James R. Jones
House of Representatives
Washington, D. C. 20515